

Saudi Arabia Tax Alert October 2012



Arabic language to be made mandatory for business purposes in Saudi Arabia

Based on recent developments Saudi Arabia has made the use of Arabic as the primary language in all commercial and business dealings, including in utility bills, advertising, and all sorts of contracts and insurance certificates.

While details of the announcement are still to be obtained, it may be interesting to note that for business owners from a Saudi tax and Zakat perspective, the maintaining of books and records locally in Arabic language has been always been mandatory.

Parties who fail to comply with the regulation will have to pay a fine of SR 100,000 (\$26,600), an amount that could be doubled, besides risking that their businesses be shut down for a year if the violation is repeated.

"The ministry calls upon all commercial establishments, markets and shops to abide by the rule immediately by using Arabic in all their price tags as the basic language, as well as in all their commercial documents including bills and contracts that are presented to consumers," according to a ministry statement.

"The new rule was imposed on the basis of commercial regulations, which insist that consumers should have full knowledge of the products and services that are offered to them in their basic language," the ministry statement said.

The law of maintaining commercial books in Arabic language has been in place for a number of years and what we have seen in practice is the Department of Zakat and Income Tax (DZIT) requiring all supporting information and documentation provided in response to a query or objection in Arabic language. The above development regarding use of Arabic language in all commercial dealings indicates the seriousness of the government on the implementation of the existing regulations.

It is therefore important that taxpayers, especially wholly owned foreign companies or mixed companies arrange the translation of the books of accounts and commercial records into Arabic in order to avoid any adverse action from the authorities.

Requirements in order to qualify for tax incentives in Saudi Arabia

The DZIT has provided a special form to be completed in case where taxpayers decide to avail the benefits of the special tax incentives in Saudi Arabia. Foreign investors will be granted tax credit (tax deduction) against the annual tax payable in respect of the following costs incurred on Saudi employees (the "Employment Incentive"), to be calculated as follows:

- 50% of the annual cost incurred on training of Saudi employees; and
- 50% of the annual salaries paid to Saudi employees, if there is any balance of tax payable after applying (1) above.

In addition, investors will be granted a tax credit for 10 years equal to 15% of the paid up capital of industrial projects whether in cash or in kind as well as in case of capital increase (the "Capital Incentive").

The following conditions need to be met in order to qualify for the Capital Incentives:

- The investor must be licensed by the Saudi Arabian General Investment Authority (SAGIA).
- The project must be located in one of the following areas: (Hail, Northern Border, Jizan, Najran, Al-Baha, Al-Jouf, industrial areas and economic cities located therein).
- The project's paid capital must be no less than SAR 1 million in cash or in kind.
- The granted deduction must not exceed 15% of the total project capital whether in cash or in kind and of the licensed capital expansions granted by the competent authorities, if any.

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- Residual balance from capital incentive that was not depleted may be transferred to subsequent years until the earlier of the full depletion of this incentive or the end of the exemption period.

The total tax deduction for training and recruiting Saudis must not exceed the project's due tax for the same tax year. It is also not allowed to transfer any residual difference from training or recruitment expenses to subsequent years.

The following conditions are required to qualify for the Employment Incentive :

- The number of Saudi employees for every tax year must be no less than 5 provided that they have principal technical or administrative functions excluding guards, drivers, workers, reviewers and non-technical labor.
- Employment contracts signed by people who are recruited or trained must be valid for no less than a year.



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- The work residence of recruited or trained Saudis must be in the area where the project is held.
- The training party - inside or outside the Kingdom of Saudi Arabia - must be accredited by the competent authorities.
- A certificate accredited by General Organization for Social Insurance must be submitted along with a statement certified by a Legal Accountant clarifying the number of Saudi employees and their paid salaries during the tax year.
- Copies of the employment contracts made with Saudi employees must be attached along with their qualifications, appointment letters and documents indicating their residences.
- Certified copies of internal or external training certificates by the issuing party must be attached.

Withholding Tax (WHT) on related parties, payment for technical services outside Saudi

The High Appeal Committee ("HAC") at the DZIT has ruled that a 5 percent withholding tax would be applicable on payments made to non-resident related parties for technical and consulting services instead of 15 percent, as per the current application.

However, we understand that the DZIT has filed an appeal with the Board of Grievance (BOG) against HAC's ruling. Accordingly, the ruling is not considered to be final as the

tax appeal rulings in Saudi Arabia are not regarded as part of the regulations.

In the interim, the DZIT will most likely continue to apply the 15 percent withholding tax rate, therefore, taxpayer may apply 15% withholding tax on payments to non-resident related parties in order to avoid any delay fine in case the decision of HAC is reversed by BOG.

Customs Duties

It may be worth noting that customs duty are payable on importation of goods and products into Saudi Arabia. The general customs duty rate for most products in Saudi Arabia is 5%. However, the Saudi customs regulations also allow for temporary admission (under certain conditions) of heavy machinery and equipment, which are not available in the market and are required for the completion of projects or the conducting of practical and scientific tests relating to those projects.

The admission shall be granted for a period of six months and renewable for similar periods, which shall not exceed three years at the most unless the completion of a project requires a longer period.

Generally such temporary admission shall be provided for one of the projects which is in favor of the government or an investment project whose completion requires the admission of such machinery and equipment for this purpose.

Furthermore, according to the Foreign Investment Act (FIA), companies licensed for industrial projects in the Kingdom are afforded the same benefits as national industries based on "The National Industries Law" and are able to qualify for certain exemptions. The National Industries Law provides that industrial projects in Saudi Arabia may import machinery, tools, equipment, and spare parts free from customs duties.

Semi-manufactured materials, raw materials, and packaging materials may also be imported duty-free by industrial projects, but only to the extent that such materials are not available in Saudi Arabia.



Advance Tax Filing reminder for December 2012

Taxpayers are reminded that in terms of the Saudi tax law, an advance payment on account of corporate income tax for the year is payable in three installments i.e. by the end of the sixth, ninth and twelfth months.

Each installment of advance payment of tax is calculated in accordance with the following formula:

$$25\% \times (A - B)$$

Where A is equal to the taxpayer's liability as per the tax return for the preceding year; and B is equal to tax suffered by the taxpayer at source (i.e. withholding tax) in the preceding year.

A taxpayer is not required to make advance payments if the amount of each payment calculated above would be less than SR 500,000 (i.e. corporate taxes payable in preceding year are less than SR 2,000,000).

The due date for settlement of the Third Advance payment for tax payers with a 31 December 2012 year-end would be 31 December 2012 with the final liability for the year payable by 30 April 2013, due date for submission of annual tax / zakat returns.





DZIT issues latest set of responses to Frequently Asked Questions

In a move to engage taxpayers more closely and also provide insights into the approach and thinking of the DZIT to certain uncertain and contentious matters; the DZIT has recently published on its website set of responses to questions on topical areas.

We have reproduced below a selection of some of the interesting questions and responses for reference. It is important to

note that the questions and responses are based on certain facts and circumstances and clients are advised to seek proper advice from local tax advisors for their specific cases.

These are only possible interpretation and are subject to the objection and appeal, should clients believe that a strong case may be made based on their specific situation.

Selected Questions and Answers

Question: Is profit distribution by Gulf companies and banks operating in the Kingdom to Gulf Governments subject to tax or zakat?

Answer: The profit distribution by Gulf companies and banks operating in the Kingdom to Gulf Governments is subject to withholding tax.

Question: What is meant by “place of central management”, stated in Article (3) (b2) of the Income Tax Law, which if met makes the company resident in the Kingdom?

Answer: The “place of central management” is the place from which a company is effectively managed and controlled. It is the place where the board of directors meet, and important policies and decisions are made regarding the company’s management, business, investments that are necessary for the operation of the company at higher level.

Question: A non-resident company deals with a Saudi Distributor to distribute the former’s goods in the Kingdom. The non-resident company stores products in the Kingdom to supply the Saudi distributor at scheduled times. Is storing products in the Kingdom subject to tax?

Answer: Under Article 4(c1) of the Income Tax Law, storing goods in the Kingdom in order to supply a Saudi distributor is not considered a permanent establishment, and therefore is not subject to tax in the Kingdom.

Question: Are commercial bonds or Islamic bonds issued by a Saudi stock company to fund its projects subject to zakat or tax in respect of the issuer and the investor?

Answer: In respect to the issuer of the bonds, such bonds represent a financial obligation, like debts, and are dealt with according to Fatwa (religious ruling) number 23665, dated 15/4/1424 H issued by the Permanent Commission for Research and Fatwa. In respect to the investor in these bonds, if the investor is a resident Saudi, the amount of these bonds and their return is subject to zakat provisions. If the investor is a foreign or a non-resident Saudi, the return of such investment shall be subject to Income Tax Law issued by Royal Decree, number M/1, dated 15/1/1425H.

Question: What is the tax treatment of a non-resident investor in regard to its investments in the Saudi Capital Market?

Answer: Capital gains realized by a non-resident investor from transactions with persons authorized to trade with the stocks of the Saudi Capital Market upon disposal of financial papers by sale are tax-exempt according the provisions of Article (10) (a) of the Income Tax Law and Article (7) of the Implementing Regulations.

Dividends paid by the company being invested in to the foreign non-resident investor are subject to withholding tax at 5% upon transfer to the non-resident investor or credit to its account according to the provisions of Article (68) of the Income Tax Law and Article (63) of the Implementing Regulations.

Question: What does the “cost base” mean in determining the capital gains upon disposition by a foreign partner of its share in a resident capital company?

Answer: Article (9) (d) of Income Tax Law stipulates that the cost base of an asset purchased, produced, manufactured, or constructed by the taxpayer itself is the amount paid or incurred by the taxpayer in cash or in kind in the process of acquiring the asset.

Question: Are fees paid to members of Boards of Directors of resident companies an allowed expense for tax purposes?

Answer: Fees paid to members of Boards of Directors of resident companies are not an allowed expense except for fees paid to stockholders of stock companies in accordance with Article (10) (1) of the Implementing Regulations.

Question: Article (61) (c) of the Income Tax Law stipulates that all persons and government bodies shall provide DZIT with information on contracts concluded with the private sector... Is this requirement limited to construction contracts or does it also include other types of contracts such as, lease contracts, sale and purchase contracts, security services contracts, maintenance services and other services contracts, and contracts concluded with non-resident parties?

Answer: Article (58) (1) of the Implementing Regulations requires all persons, natural or corporate, to provide DZIT with the basic information specified in Article (61) of the Income Tax Law, with regard to construction, service and delivery contracts, and their amendments that they may conclude with any person from the private sector. Article (58) (4) of the said regulations states that this requirement applies to contracts of all types and nature and with resident

or non-resident parties, with exception of contracts of a value less than one hundred thousand riyals.

Question: Are cash payments for investment by a branch in the Kingdom to its head-office abroad subject to withholding tax?

Answer: If cash payments for investments by a branch in the Kingdom to its head-office abroad are to finance the branch’s investments abroad and the income from such investments is reported in the accounts of the branch in the Kingdom and the investment principal will be finally returned to the Kingdom, there is no withholding tax on such payments. If these payments are transfers to the head-office, they are considered profits transferred to associated parties and should be subject to withholding tax at a rate of 5%.

Question: Is freight and Insurance cost for goods delivered to the Kingdom (CIF or FOB) subject to withholding tax?

Answer: Under Article 5 (7) and Article 63 (4) of the Implementing Regulations, cost of freight and insurance of goods delivered to the Kingdom (CIF or FOB) shall not be subject to withholding tax as it is considered part of the cost of goods.

Question: Is withholding tax applicable to payments to airlines agents and representatives who are resident in the Kingdom and have commercial registers and file with DZIT?

Answer: Payments to resident airlines agents and representatives are not subject to withholding tax; but transfers of such amounts by resident agents and representatives to non-resident transportation companies shall be subject to withholding tax at a rate of 5%.



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Question: Are payments to non-resident parties for obtaining news reports (political, economic, sports .etc.), for correspondents' services, or subscription in on-line stock screens subject to withholding tax?

Answer: Payments to non-resident parties for obtaining news reports, or for correspondents' services are considered payments for other services, and payments for subscription in on-line stock screens are considered payments for royalties, and in the three cases such payments are subject to withholding tax at a rate of 15%.

Question: What are the penalties payable by the taxpayer if it files a return of income above one million SR without certification by a chartered accountant?

Answer: Article (76) (a) of the Income Tax Law stipulates that a taxpayer not complying with the provisions of Article (60) (a, b, d, f) of the said law shall be subject to a fine. Article (60) (a) of the said law stipulates that every taxpayer required to file a return shall file it in the prescribed form. Article (67) (1) (b) of the Implementing Regulations stipulates that a fine for failure to file the return shall apply in case of failure to file the return in accordance with the approved form, even if filed within the due date.

Therefore, absence of certification by a chartered accountant of a return of income above one million SR makes the taxpayer subject to the fine stipulated by Article (76) (a) of the Income Tax Law due to failure by the taxpayer to comply with the above provisions, i.e. failure to comply with the approved form.

Claiming refunds in case of Double Tax Agreements

Over the last few months we have had numerous queries from clients regarding application of the attached "pay now claim later" circular to be applied in terms of the Saudi Arabian Double Tax Agreements (DTA).

As a result of this circular issued in May 2010, WHT on payments made to non-residents residing in countries with whom Saudi Arabia has a DTA that allows for exemption or reduced WHT rates, Saudi residents payees are required to apply full rate of WHT as provided under the tax law, and later claim refund of the overpaid WHT.

The circular has also provided some mechanics of the process and required documents.

The application of provisions of the circular is having a major impact on cash flow and financial planning of many clients. Furthermore it also somehow appears to defeat the very purpose of having a DTA in the first instance.

Client queries have focussed on these areas:

- Can we argue that the DTA overrides local law and the circular and pay the DTA / lower rates where applicable?
- On the issue of "fees for technical services" whereby based on our understanding of most DTA provisions, should not be subject to WHT in Saudi; unless a PE is present here?

- Will DZIT accommodate an advance ruling or clarification to avoid the process of claiming refunds etc. in case where a long term contract is in place?

- What about recurring payments and long term contracts?

- Practicality of providing original documents and payment receipts.

Furthermore, a suggestion is to get clients to pay the DTA / lower rate where a DTA is in effect and wait for DZIT to query? If the DZIT do impose penalties etc. hopefully clients would be able to:

- Confirm they are tax resident in a treaty country,
- Justify that they have declared the income in their foreign tax filings,
- Argue that the DTA overrides local domestic law,
- Request DZIT to pay back refund with interest at 1% from date on which higher amount was paid, not on date claim for refund is made?

The above concerns have been raised with the DZIT and a formal response is being awaited.

The New Saudi Finance Laws

The Saudi Council of Ministers has recently issued 5 new laws in relation to the finance industry, with more focus to real estate financing, as well as the execution / enforcement mechanism.

These laws are the Execution / Enforcement Law; the Registered Real Estate Mortgage Law; the Real Estate Financing Law; the Law on Supervision of Financing Companies and; the Finance Lease Law. It is expected that these laws will have a major impact upon the mortgage and finance markets.

The implementing regulations of these laws should be issued within the coming months by the relevant authorities and the details below provide only a brief indication of what may be expected.

Furthermore, it is hoped that the implementing regulations would provide clarity on application from a Saudi tax and Zakat perspective, since the treatment of such transactions may result in adverse implications in certain instances. A brief overview of these laws is provided below.

The Execution Law (EL)

Under the EL, execution and enforcement procedures will be carried out by specialized Execution/Enforcement Judges (EJ) in the general courts in the main cities and districts.

Specifically, the EJ would be in charge of enforcing any judicial resolution issued by the competent courts, judicial authorities, arbitration tribunal, as well as, judgments and arbitration awards issued outside the Kingdom. Additionally, the EJ will be entrusted with the authority to seek police support in relation to enforcement.

The Registered Real Estate Mortgage Law (RREML)

The mortgage under the RREML refers to a contract where the mortgagee obtains rights on a certain real estate, pursuant to which the mortgagee may seek settlement of the debt owed to it.

It provides a new framework for security over real estate, including, for the first time, provision for second ranking mortgages.

The Real Estate Financing Law (REFL)

The REFL provides that the Saudi Arabian Monetary Agency (SAMA) would be responsible for the supervising real estate financing practice in the Kingdom.

It provides for the authorisation and licensing of banks and finance companies to enter the real estate finance market, for the dissemination of information within the market, and for enhancing liquidity with measures to promote a secondary market (both through mortgage refinance companies and securitisation) and new methods for government financial support.

The Law on Supervision of Financing Companies (LSFC)

SAMA will be the regulatory body to license finance companies in the Kingdom. The LSFC provides that a finance company will be in the form of a joint stock company and that a certain percentage of the finance company must be offered through a public offering after two financial years.

SAMA will also determine the maximum foreign ownership allowance in the finance company.

The LSFC provides a framework for Shari'ah compliant finance companies to enter the market alongside banks as providers of finance for real estate and other assets, including alternative forms of finance such as lease finance and micro finance.

The Law also provides that the DZIT will issue the criteria for calculating Zakat base on finance companies, one of the few laws in Saudi Arabia allowing for tax / zakat treatment to be clarified specifically by DZIT.

Finance Lease Law (FLL)

The FLL is intended to regulate the large market in finance leasing currently being practiced throughout the Kingdom. Under the FLL, a lessor, under a lease contract, may lease assets or utilities in his capacity as the owner of these assets, or owner of interests arising from these assets.

This law may have some important implications from a Saudi Zakat perspective and it is expected that clarification from DZIT in this area would also be useful.

Capital Market Law Update

Separately, there is an amendment to the Capital Market Law to facilitate the licensing and regulation of 'special purpose vehicles' by the Capital Market Authority, paving the way for their use as securitisation vehicles (and possibly for other uses).

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KPMG's MESA Tax Conference - 26 November 2012

Shifting Sands - Coping with changes in the Middle East and South Asia Region

KPMG MESA will be conducting a one day conference on 26 November 2012 at the Ritz-Carlton, DIFC in Dubai, which is aimed at:

- Analyzing the changes in the MESA region alongside eminent speakers from government, international and regional businesses, academia and the media.
- Delivering practical strategies and ideas guided by insights from leading tax professionals and industry leaders.
- Looking beyond today's shifting sands to the shape of the future ahead.

The agenda for the KPMG Middle East South Africa (MESA) Tax Conference 2012 has been confirmed and registration now open. There is a plenary session Tax Compliance in the region and there is a special session on investment in Saudi Arabia being facilitated by KPMG professionals from Saudi Arabia.

Further details and registration information may be obtained from the dedicated website below:

http://www.kpmgmesataxconference.com/programme_details.html

We look forward to seeing you at the Conference!

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